The European Union－Japan Trade Cooperation:

Towards a Free Trade Agreement*

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Introduction

The purpose of the paper is to develop an analytical framework of EU-Japan Free Trade Agreement (FTA). In general, consumers gain surplus from international trade (Carbaugh, 2013, pp. 123–124). Improving the relative price (ratio of import/export), real income is getting increased. For instance, when jeans can be produced at JPY 700 in China, it is economically irrational to produce them at JPY 7000 in Japan. Revenue of producers may decrease by free economic trade internationally. However, consumer surplus will exceed over their losses. Socially, this surplus improves social welfare. In short, international trade generally improves social welfare.

As the practical background, in 2013, the European Union and Japan launched negotiations on a new trade and economic agreement, of which the strategic aim is to create a free trade area between the parties. It was called, EU-Japan FTA. This new agreement, which is being negotiated[1], should include a broad spectrum of economic issues not only traditionally relating to tariffs, trade in goods and services, but also more broadly to non-tariff barriers and trade procedures, foreign direct investments, legal protection of intellectual property, competition policy, and public procurement and so on. In this sense, the EU-Japan FTA should be a comprehensive agreement enhancing EU-Japan trade and economic cooperation. That is why it is called, especially by the Japanese side, as 'economic partnership agreement' (EPA).

The economic potential of the European Union and Japan is not reflected in current bilateral trade and investments links between the partners. Trade and investment volume is below the potential and therefore the agreement should create a new comprehensive framework for economic bilateral cooperation and became a long-awaited incentive for

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1 There have been seventeen negotiating rounds as of 1st October 2016.

revitalizing the EU-Japan relationship. From the EU's perspective, Japan remains a relatively closed market in economic terms, thus the agreement will be an opportunity to improve openness of the Japanese market for European exporters and investors, and to abandon many nontariff barriers that have burdensome effects on trade and investments.

The negotiations fit also in the general global process of increasing importance of preferential bilateral and regional agreements within the framework of the international trade system, which has been observed globally from the 1990s. Although the agreement is being negotiated in the shadow of two other important agreements[2], the EU-Japan FTA may be classified as a megaregional trade agreement due to the economic, trade and investment potential of both partners and their position in global value chains. Additionally, the accepted agenda for negotiations foreshadows a deep economic integration once the agreement is achieved, including regulatory compatibility and rules aimed at limitation of differences in investment and business climates, which is characteristic for megaregional agreements (WEF, 2014). The potential agreement will encompass countries responsible for about 1/3 of the global GDP. They are also global scale traders－together they are responsible for about 20% of the global trade (excluding EU-intra trade) and are the source of 1/3 of global foreign direct investments (UNCTAD, 2015; WTO, 2015a). This makes that EU-Japan FTA will not only affect the parties involved in the negotiations process, but also will influence the global trade and investment architecture.

However, there are several claims in EU-Japan FTA negotiations on each side. This paper identifies main barriers and challenges for European enterprises in access to the Japanese market for European goods, services and investments. Methodological approach will employ the historical archive reviews. As the evidence of findings from this paper, some records of agreements and negotiations will be discussed. The methodology used for identifying the mentioned barriers/challenges includes: statistical analysis of historical trade and investment co-operation (from Eurostat, JETRO, JMF, OECD, WTO and UNCTAD), the analysis of legal acts regulating trade co-operation between the EU and Japan, including official documents corresponding to the ongoing negotiation process, the analysis of official reports presenting surveys on European companies operating in Japan on main barriers faced in export and investments as well as sector reports prepared by EU-Japan business and trade organizations. The identification of main barriers for the European enterprises in access to the Japanese market as well as classification of potential trade and investment expansion sectors have enabled to formulate main challenges for European enterprises that should be addressed by European negotiators during the EU-Japan FTA negotiations.

To achieve the primary purpose, the article has been organised as follows. The first

2 This agreement includes, so called, Trans-Pacific Partnership (TTP) and Transatlantic Trade and Investment Partnership (TTIP).

section presents a brief summary of the EU-Japan relations from a historical perspective. Then, in the second section, some general picture of the EU-Japan economic relations is presented with a focus on trade and investment links, including the most recent statistics within this area. The third section refers directly to the mentioned aim and identifies main barriers/challenges for European enterprises in access to the Japanese market in chosen sectors of trade in goods[3]. The chosen sectors are of a great importance for EU exports to Japan and represent a wide spectrum of relevant barriers existing for foreign suppliers. Some general barriers have been also identified for EU companies in allocating foreign direct investments and utilizing the potential of the public procurement market in Japan. Then, in the fourth section, a preliminary analytical framework will be discussed. Through this discussion, FTA negotiation will be analysed not only in economic terms, but also from the political and sociological perspective. And, in the last section, short summary shall be concluded.

1. A Historical Perspective on ECC/EU and Japan Relations

Historically, EU-Japan economic relation can trace back to establish the European Economic Community (ECC) in 1957. EEC was the economic community in which Belgium, France, Italy, Luxembourg, the Netherlands and West Germany were originally belonged. It became the European Community (EC) in 1993, then, it was absorbed into the European Union (EU) in 2009.

Officially, EEC/EU-Japan relations began in 1959 with the accreditation of Japanese ambassador to Belgium as well as－as a first representative in history－to three European Communities, which was the aftermath of the visit of the Prime Minister of Japan in European capitals, including Brussels (Frattolillo, 2013). However, it took 15 years to establish the delegation of the European Communities in Tokyo in 1974, which proves that the relations between the parties in the first years were generally relatively weak. At that time, bilateral relations were influenced strongly by trade and economic issues.

In the 1960s and 1970s, Euro-Japanese interactions were characterized as economic frictions. Growing Japanese export expansion in sectors and industries was considered by Europeans as important in terms of employment and income/growth potential and chronic trade deficit for the EEC influenced strongly the agenda of bilateral cooperation (Waldenberg, 2013). Starting from the early 1970s, EEC countries experienced also the first boom in foreign direct investments by Japanese companies which were accompanied by hostility towards Japanese trade practices (Yoshida et al., 2008). Moreover, it was even more difficult to develop bilateral relations beyond the economic nexus, as both partners

3 Food and agricultural products, pharmaceuticals and cosmetics, automobiles and automotive components.

were affected by the negative impact of the oil shock around 1978.

In the 1970s and 1980s, although the main axis of bilateral EEC-Japan relations were efforts to correct the trade imbalance[4], new initiatives in co-operation started to grow. In 1979, the European Commission launched the Executive Training Programme (ETP) to increase knowledge about Japan, its language, culture and business environment among European businessmen. Through ETP, the increase of effectiveness of European industries in their practical efforts to penetrate the Japanese market was expected. Additionally, in 1987, the EC-Japan Centre for Industrial Cooperation was opened in Tokyo to stimulate broaden industrial cooperation and support diffusion of trade tensions (Schweisgut, 2014).

Although the 1980s brought some increasing political activity in bilateral relations[5], more noticeable turn came with the beginning of the 1990s. The beginning of the new decade brought a new geopolitical situation at the European continent, namely, the fall of communist system in Central and Eastern Europe and the unification of Germany. Moreover, the European Community was heading towards deeper economic and political integration. The Community started to implement two important projects aimed at deeper integration between EC member states, namely a common market and economic and monetary union.

The beginning of the 1990s witnessed also new initiatives in building closer EC/EU relations with Japan, including more political aspects. In 1991, during the first EC-Japan summit held in The Hague, the parties adopted "*The Joint Declaration on Relations between the European Community and its Member States and Japan*" which was creating an institutional framework for more intensified dialogue and stronger partnership. This new institutional framework included annual consultations in Europe or in Japan between, on the one hand, the President of the European Council and the President of the Commission and, on the other, the Japanese Prime Minister (EU-Japan summits), an annual meeting at ministerial level as well as the continuation of six-monthly consultations between the Foreign Ministers of the Community and the Member of the Commission responsible for external relations (Troika) and the Japanese Foreign Minister (Joint Declaration, 1991).

The Hague Joint Declaration became the institutional landmark for more complex EU-Japan co-operation in new areas. As stated in the declaration, "*The European Community and its member States and Japan will firmly endeavour to inform and consult each other on major international issues, which are of common interest to both Parties, be they political, economic, scientific, cultural or other. They will strive, whenever appropriate, to co-ordinate their positions. They will strengthen their co-operation and exchange of information both between the two Parties and within international organizations*". Following the declaration, the EU-Japan cooperation has expanded beyond original focus on economic issues and trig-

4 Japan agreed to various voluntary export restrictions.

5 In 1984, the EEC and Japan held the first ministerial meeting.

gered a number of sectoral dialogues in a wide variety of policy areas, including peace and security, global and societal challenges (Frontini, 2016).

Trade and investment co-operation in 1990s were characterized not only by the normalization of economic dialogues, but also by losing interest in bilateral trade and investment links mostly due to economic processes in the parties' neighborhood[6] (de Prado, 2014). Also, the announced declaration's objectives of closer political co-operation were far from ambitious implementation and an attempt to substantiate visionary political links largely failed

During the 10th EU-Japan summit in Brussels in 2001, the parties decided to give a new incentive for bilateral activity. The representatives of the EU and Japan adopted "The Action Plan for the EU-Japan co-operation. Shaping our common future", including four major objectives: promoting peace and security; strengthening the economic and trade partnership utilizing the dynamism of globalization for the benefit of all; coping with global and societal challenges; and bringing together people and cultures. The document emphasized the ambitious outline for closer cooperation between the partners, but many analysts pointed rather modest realization of the plan's goals in following years. Although the EU and Japan developed dialogues in many political, economic, social or environmental issues (according to the European Strategic Partnership Observatory maintained by the think-tank FRIDE, there were 34 EU-Japan Dialogues in 2013 (de Prado, 2014)), many of them were not very active and substantial. However, the diagnosis does not reflect the development of EU-Japan dialogues on economic issues[7] and high-level forum on science and technology (de Prado, 2014).

Again, new ideas for enhancing bilateral EU-Japan co-operation appeared at the end of the decade. Policy-makers on both sides agreed that the agenda and listed issues to be addressed in bilateral cooperation included in the 2001 EU-Japan Action Plan were far too ambitious and contributed to poor implementation of the action plan into effect. As the aftermath in 2010, representatives of both sides agreed to set up the EU-Japan Joint High-Level Group (HLG), the task of which was to discuss and define new format of bilateral EU-Japan framework agreement (Berkofsky, 2012).

In March 2011, the European Commission, following the meeting of HLG, published a document *"Options for the Future Framework of EU-Japan Relations"*, in which it presented the Commission's ideas on the shape of institutionalized EU-Japan relations and cooperation in future. Following the Commission's proposal, during the 20th EU-Japan summit held in Brussels, the parties agreed to start the process of parallel negotiations on "*(1) a deep and comprehensive Free Trade Agreement (FTA)/Economic Partnership Agreement (EPA), addressing all issues of shared interest to both sides including tariffs, non-tariff meas-*

6 This can be seen in growing economic co-operation in Asia-Pacific region, political and economic transformation in Central and Easter Europe.

7 These were trade, deregulation, and industrial policy.

ures, services, investment, Intellectual Property Rights, competition and public procurement ; (*2*) *and a binding agreement, covering political, global and other sectoral cooperation in a comprehensive manner, and underpinned by their shared commitment to fundamental values and principles*". (Council of the European Union, 2011). To this end, both parties agreed to conduct a joint definition of the scope and level of ambition and the European Commission declared to seek the necessary authorization from the Council to start the negotiations with Japan (Council of the European Union, 2011). Formally the bilateral negotiations for a Strategic Partnership Agreement and a Free Trade Agreement were launched two years later, during the 21st EU-Japan summit in March 2013.

2. The European Union and Japan as Trade and Economic Partners

So far, a brief review on historical events between EU-Japan relation has been done. For the review, here, mainly two findings can be formulated. The first one is EU-Japan economic relation has been institutionalized for a long time, more than 60 years since their first negotiation. Second, their relations are still improving.

In this section, the analysis concentrates on trade performance between the partners. Actually, information has been already published, but to the analysis helps to know how much they contribute or depend on each and through this it contributes to the realization of this paper's purpose. First, the result of Japan will be tabulated, and then, added some evaluations.

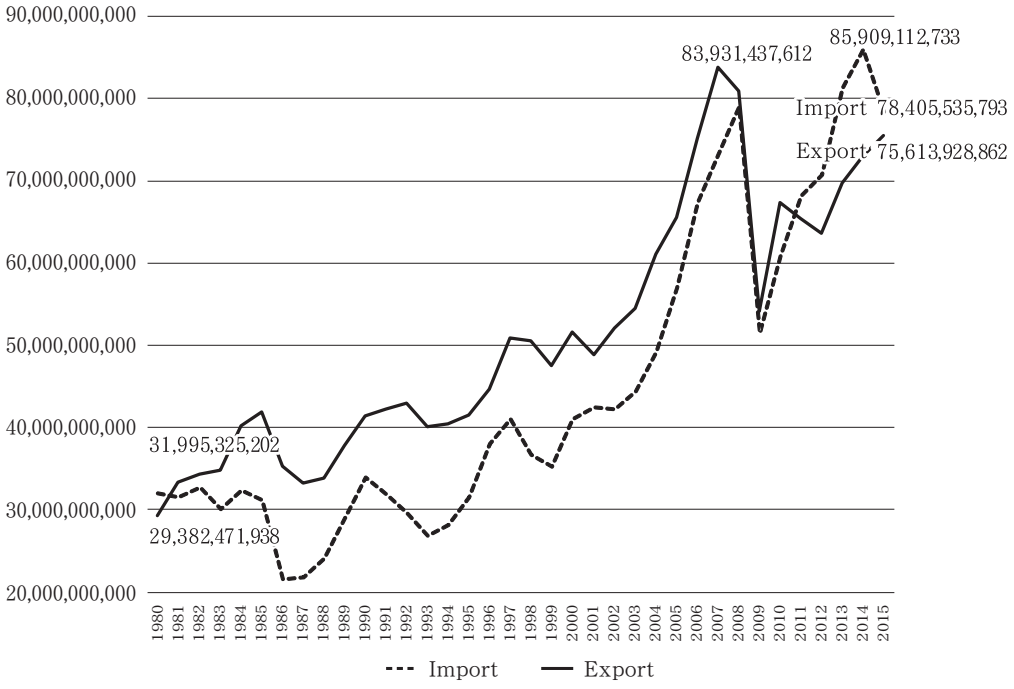
2–1. Status Quo in Japan

Japan has been known as an export oriented nation. There are some who support the view that Japanese growth was export-led (Blumenthal, 1972). By contrast, Porter (1990) suggested that Japanese export success merely reflected favorable domestic conditions. According to his opinions, highly competitive domestic conditions has been led by innovation in both products and management techniques. He stated, "In nearly every industry we studied, exports increased substantially only when the domestic market became mature" (Porter, 1990, p. 402). He adds that demanding consumers and unusual demand conditions also played a key role, as did the availability of factors of production, particularly physical and human capital. In this view, Japanese export prowess was the result of strong domestic productivity growth. He concluded, "Japan must import more if vibrant productivity growth is to continue. Imports stimulate domestic productivity growth" (Porter, 1990, p. 708).

Growth mechanism can be identified several ways (Lawrence and Weinstein, 1999). From macro information of trade statistics of Japan, import and export performances have generally contributed for some decades. Figure 1 shows the trade statistics of import and export in Japan. These are nominal results, and results showed as import JPY 78,405,555,793

(unit, thousand; 78 trillion 405 billion 555 million 793 thousand; USD 653,379,632 thousand) and export JPY 75,613,928,862 (USD 630,116,074 thousand) in 2015.

These growths can be divided into several periods. Around 1980 to 1985, after the second oil shock, Japanese economy was getting increased. Specifically, automobile and high-tech appliance led this growth. Since 1985, domestic economy has been experienced unprecedented prosperity, called bubble economy by 1991. However, during 1986 to 1987, since the yen had rapidly strengthened against the dollar, export decreased and led domestic economy declined. Since 1988 till 1990, as real estate and stock prices had been getting to the summit, both import and export rapidly recovered. December 29, 1989, Nikkei stock price average indicated the peak ever, at JPY 38,915. Compared to average stock price around JPY 13,000 in 1986, it was to almost triple, but it precipitately declined by less than JPY 20,000 till October 1990, bubble collapsed. In 1994, both growth with Asian countries and decline JPY value, Japanese economy somehow recovered through export increasing by 1997. In 2002–2007 JPY was depreciating and the domestic economy drastically revived. In 2008, financial crisis from USA stroke also the Japanese economy and put it into recession. In 2011, the biggest earthquake in world history destroyed geographically north part of Japan and physically damaged many factories as well. Export quitted to grow again. Since 2011, based on huge growth of Asian emerging economies, import exceeded export. In 2014, import achieved the summit ever, but since that time it has been getting declined.



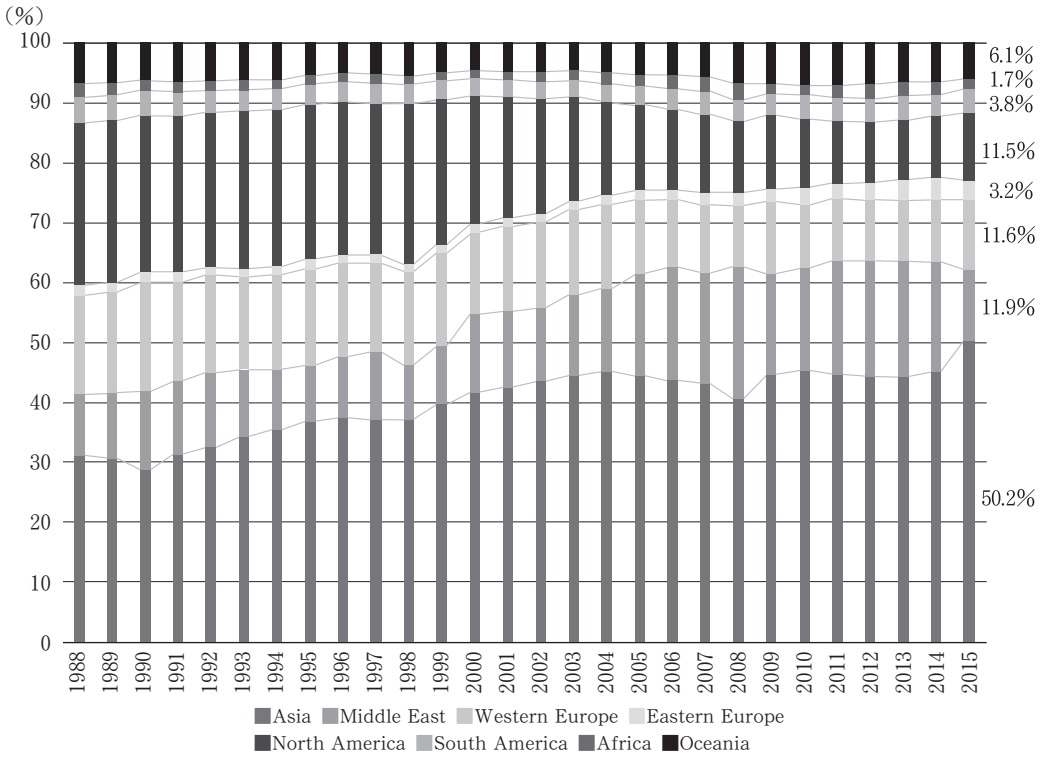
(Source: Trade statistics of Japan, Japan ministry of finance)

Figure 1 Japan import-export records (1980–2015, Unit: thousand JPY)

Though international trade does not necessarily relate to domestic economic prosperities, it strongly influences the occupancy rate of production (i.e., productivity). GDP growth rate of Japan in 2015 was 0.54% (160th out of 189 countries). Compound annual growth rate of export since 1980 to 2015 is 2.74% and import is 2.59%.

With regard to EU relation, there are records on geographical segment reports. Figure 2 and Figure 3 show import and export results for last three decades, respectively. The classification of segments is divided in eight as follows: 1) Asia, 2) Middle East, 3) Western Europe, 4) Central and Eastern Europe, and CIS, 5) North America, 6) Central and South America, 7) Africa, and 8) Oceania[8].

As discussed above, in 1992, the Treaty on European Union (known also as the Maastricht Treaty) undertaken to integrate European counties was signed by members of the European Community. At that time, the members of the EC were: Belgium, Germany, France, Italy, Luxemburg, The Netherlands, Denmark, Ireland, UK, Greece, Portugal and Spain. Then, in 1995, Austria, Finland, and Sweden joined the EC. In 2004 the EC enlarged and 10 new countries joined the Community: Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia. In 2007, Romania and Bul-



(Source: Trade statistics of Japan, Japan ministry of finance)

Figure 2 Import records in Japan (1988–2015)

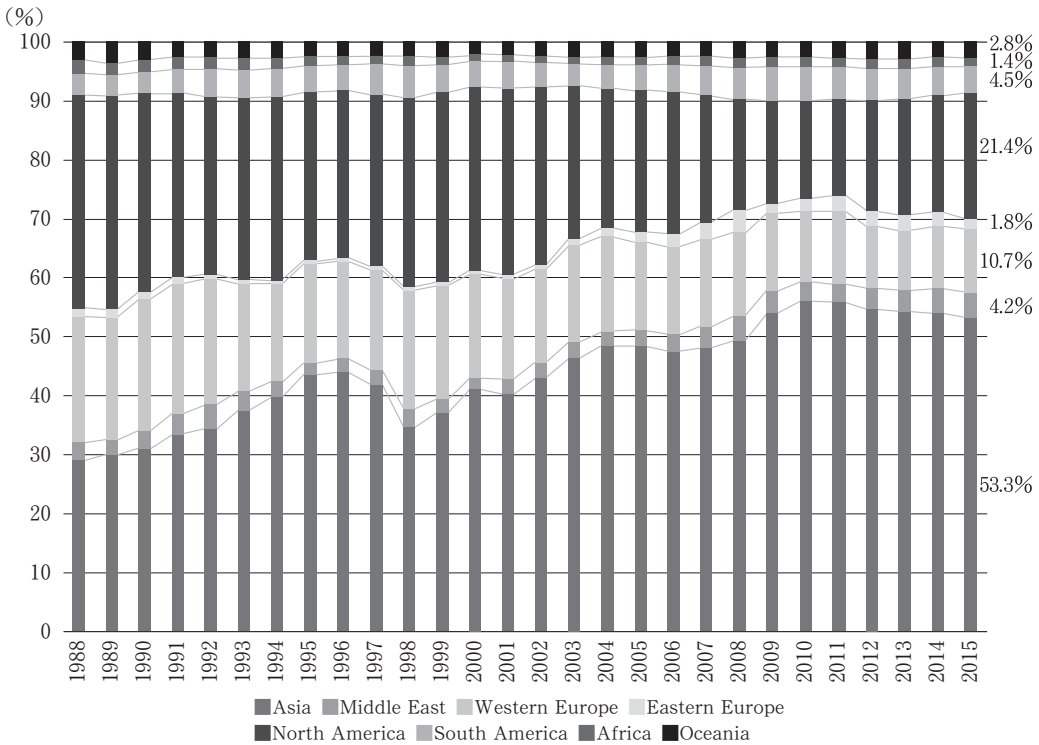
8 Indeed, the other segment is identified, but it takes only 0.0003% share in import in 2015 and no export. Here, it is regarded as negligible.

garia became EU members. So did Croatia in 2013, and now EU consists of 28 counties. This transition influenced the share of import and export in Japan. The ministry of finance categorized EU segment, but as indicated above, the size of the EU was changing over time and the organization has been getting bigger. That means both import and export automatically increase. The share of EU segment will be discussed later.

Here, first, standard regional segment by the Ministry of finance will be considered. Figure 2 shows import result of Japan, namely, how much did Japan buy the products from above regions all over the world. As some data availability was restricted, here import and export records are figured since 1988, but the main discussion of this paper will not be influenced.

From Figure 2, three issues can be indicated. First, Japan imports mostly from other Asian countries from last two decades (6.45% of annual growth rate in 1988–2015). Second, import share from North America has been decreasing. This implies that the productions in North America have been declined. And third, imports from Europe, Western Europe and Central and Eastern Europe and CIS, have been occupied, not magnitude but, significant share for last two decades.

Figure 3 shows export results since 1988 in Japan. From the figure, three issues can be addressed as well. First, export to North America took the biggest share before 1990s.



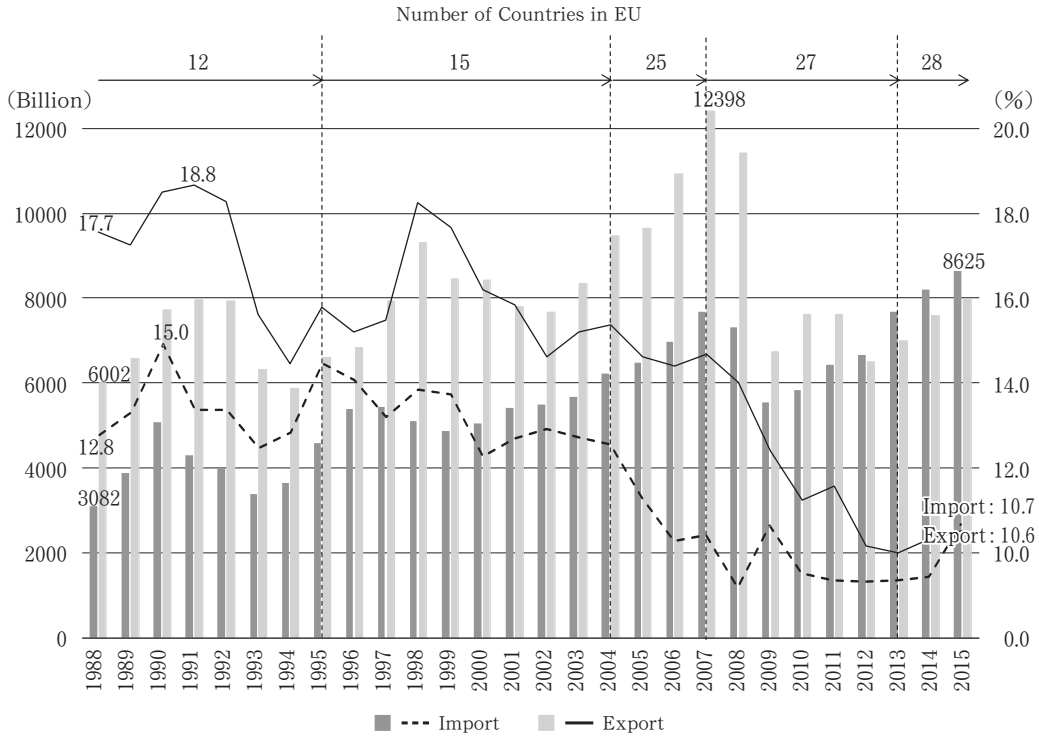
(Source: Trade statistics of Japan, Japan ministry of finance)

Figure 3 Export records in Japan (1988–2015)

Automobile export contributed to this result, and it still occupies huge amount of share in export from Japan, but the destinations might be shifted. Second, it is somehow related to the first issue－China occupies more than half of export share since 2008. China had been regarded as the factory of the world, but now it must be also regarded as the market of the world. And third, the share of export to Europe has been declined. Before 1990s, the export shares to Europe amounted to more than 20%; now, it is only about 15%.

Figure 4 shows import and export volumes with the EU. Figure 4 has three indicators. First, there are two lines. The solid line refers to export from Japan to the EU. The dot line presents import from the EU to Japan. These are measured by the left vertical axis for unit as billion. Second, the right vertical axis refers to share of import and export of the EU in Japan. They are described by two columns, a dark gray and a light gray, respectively. And third, as the number of EU countries varied, these numbers are listed.

Then, from these results, three issues can be identified. The first one is that export has been exceeded import for a long time until 2012. That means that EU bought Japanese products more than sold to Japan. However, during these period, compound annual growth rates of export were not enough large, as showed in Table 1. Indeed, by 2007, export to EU has grown even some fluctuation existed, but after the financial crisis in 2008, the levels of export barely kept close to those of early 1990s. Second, compared to export,



(Source: Trade statistics of Japan, The ministry of finance)

Figure 4 Import and export result with EU (JPY)

import can be described as relatively stable growth, but not huge, only 3.88% growth during the last 27 years. Furthermore, since 2012, imports have exceeded export. This means, that now Japan records some trade deficit with the UE. And third, 27 years below can be divided in three periods: before 1996, since 1997 to 2007, and after 2008. Because, during these three periods, sales averages are significantly different, shown in Table 2. They might almost correspond to the increasing the number of EU members.

Table 1 Compound annual growth rates

	1988–1995	1988–2004	1988–2007	1988–2015
Import	5.82	4.47	4.91	3.88
Export	1.36	2.88	3.89	1.06

(Source: own calculations on Trade statistics of Japan, Japan ministry of finance)

Table 2 Averages among three periods (Unit: thousand JPY)

	1st. before 1996	2nd. 1997 to 2007	3rd. after 2007
Import	4,133,115,483	5,845,394,133	7,015,730,310
Export	6,873,677,905	9,126,794,118	8,320,353,629

(Source: own calculations on Trade statistics of Japan, Japan ministry of finance)

With regard to share, here, three issues will be discussed as well. First, export has been bigger beyond import until 2012. It has been realized as export role for Japan. Second, import is getting bigger than export since 2012 And third, all periods might be divided in two: before 2001 and after 2002. In the former period, average of import was 13.4% and the latter period was 10.6%. About export, the former period indicated 16.9% and the latter was 12.9%.

2–2. Japan as a trade and economic partner of the European Union

So far, international trade, both import and export of Japan have been reviewed. Here, as a brief summary, following two findings can be suggested. First, import and export are recovering since 2009. Second, international shares of EU for Japan seem recovering as well. At least, both shares have been reached bottom around 2013.

Compared to above section, EU perspective will be discussed in this section. As one of important trade partners for the European Union, Japan's position is linked to trade and investment potential of its economy. In 2015, Japan was ranked as the 7th biggest trade partner of the European Union with a share in EU total trade volume of 3.3% (respectively 3.5% and 3.2% of total import and export). The European Union corresponds to the 2nd import partner of Japan and the 3rd biggest export market for Japanese goods, shown in Table 3.

However, as showed in Figure 4, the decline in bilateral trade is even more noticeable in relative terms. Starting from the 1960s/70s the share and therefore importance of Japan

Table 3 Main trade partners of the EU and Japan

European Union (2015)				Japan (2015)			
Import	%	Export	%	Import	%	Export	%
China	20.3	USA	20.7	China	24.8	USA	20.1
USA	14.3	China	9.5	EU-28	11	China	17.5
Russia	7.9	Switzerland	8.4	USA	10.3	EU-28	10.6
Switzerland	5.9	Turkey	4.4	Australia	5.4	South Korea	7.0
Norway	4.3	Russia	4.1	South Korea	4.1	Taiwan	5.9
Turkey	3.6	Japan	3.2	Saudi Arabia	3.9	Hong Kong	5.6
Japan	3.5	Norway	2.7	Taiwan	3.6	Thailand	4.5
South Korea	2.5	UAE	2.7	UAE	3.6	Singapore	3.2
India	2.3	South Korea	2.7	Malaysia	3.3	Australia	2.1
Brazil	1.8	Saudi Arabia	2.2	Thailand	3.2	Vietnam	2.0

(Source: own calculations on EC, 2016 and JMF, 2016)

as a trade partner of the European Economic Community was increasing, which was the embodiment of growing global orientation of both Japanese and European economies. After two decades of spectacular growth of bilateral trade Japan became in the late 1980s and 1990s the most important trade partner of the EEC countries in Asia[9], and the second most important one globally after the United States. In 1988, Japan was the Community's second-biggest supplier, accounting for 11% of its imports, and its fifth-largest customer, taking 5% of its total export (MEMO 20/90, 1990). The same applies to Japan for which the EEC countries were among leading trade partners. Referring to the same year 1988, the EEC share in total Japanese export and import amounted to 17.7% and 12.8% respectively, which gave the mentioned European countries the second position, after the US, among most important trade partners (JMF, 2016).

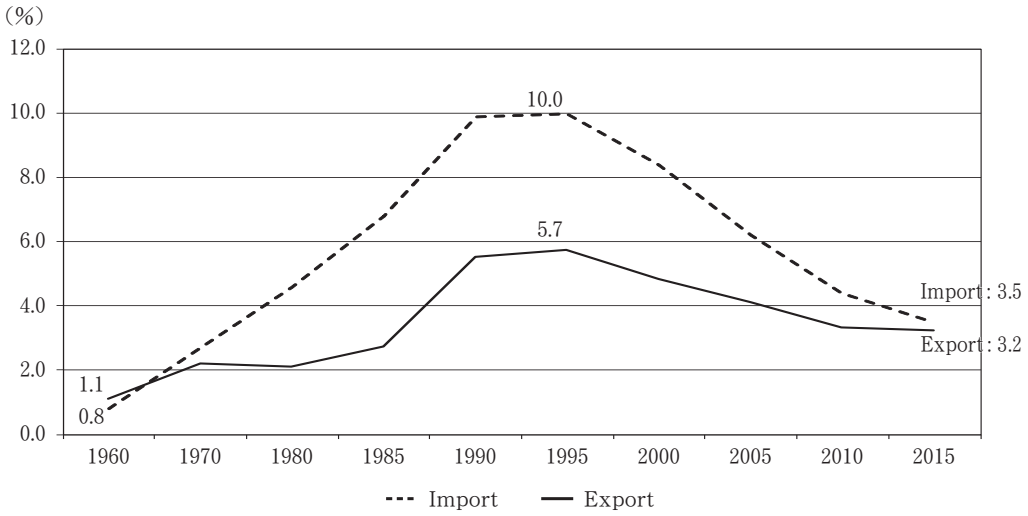
Starting from the first half of the 1990s, when Japan was the most important Asian trade partner for EC countries, the share of the country in both total EC import and export has declined substantially. The structural changes in global trade and economy[10] as well as economic situation[11] in both partners have determined that today's EU-Japanese merchandised trade lost its historical dynamic and significance. Japanese share in total EU external import and export is currently only one-third and a half respectively of the values recorded two decades ago (Figure 5).

The process of declining importance of Japan as a trade partner for the European Union is also perceivable from the trade intensity index, presented at Figure 6. During the

9 Largely in Japan's favor due to the export-oriented policy of the country which resulted in chronic deficit for the EEC.

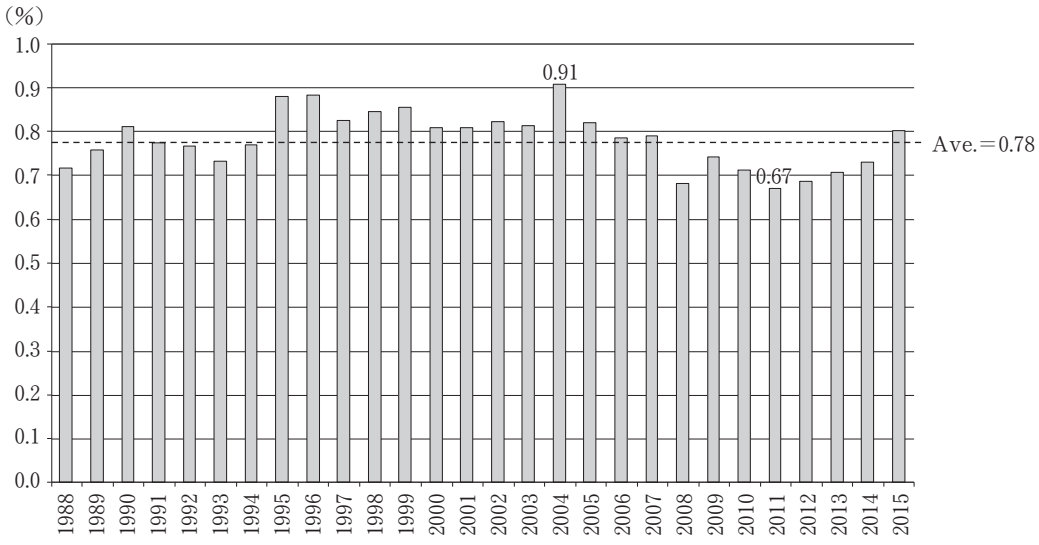
10 This shift in EC Asian import moves from Japan to China and South-East Asian countries.

11 Substantially, they imply the modest economic growth and consumer demand.



(Source: own calculations on EC, 2015; Eurostat, 2011; Eurostat/Comext, 2016)

Figure 5 The share of Japan in total extra-EEC/EU trade in 1960–2015



(Source: own calculations on Eurostat/Comext, 2016; OECD Trade Database, 2016; WTO, 2016)

Figure 6 EEC/EU trade intensity index with Japan in 1988–2014

whole period 1988–2014, the index value was below 1, which means that the ECC/EU export to Japan was smaller than would be expected on the basis of the importance of both partners in world trade. Last years, the trend was slightly downward and at present the index value amounts to only around 0.8.

3. Trade and Investment Barriers to the Japanese Market

The European Union has a lot of arguments for concluding the new free trade

agreement. The European export enters the Japanese market under relatively low tariffs－68.7% of European products exported to Japan are duty-free and the average customs tariffs amounts to only 1.7%. However, European exporters still encounter many non-tariff barriers which are recognized by most of studies and public consultations as a major barrier to EU exports to Japan. Contemporary agenda between EU and Japan are listed in Table 4. This section will discuss mainly EU agenda, and Japan agenda will be added if necessarily.

Table 4 Agenda from EU and Japan

Agenda	EU	Japan
Non-Tariff Barriers	Automobile, pharmaceutical, medical equipment, condiments	
Tariff Abolition	Processed foods, wine	Assembled products (automobile, electric appliances)
Accessibility	Government procurement, investment, services	Investment, service, contents
Regulation	Geographical indication (GI)	Transparency, simplification

As the EU side argument, Japan is regarded as still closed, especially for agricultural products, some transport equipment and aeronautical products. The mentioned non-tariff barriers affect mostly those business sectors which cover the lion's share of EU export, i.e. processed foods, chemicals (including pharmaceuticals), medical devices, automotive and transport equipment, telecommunication and financial services (EC, 2012). European exporters and investors cannot fully utilize the potential of Japanese market due to trade impediments preventing a higher degree of economic cooperation. According to a survey conducted in 2009 among 120 European firms exporting to and operating in Japan within the above mentioned sectors, 3/4 of the companies perceive the Japanese market as more difficult than the other ones. Language barrier, differences in consumer preferences as well as technical standards and regulatory issues were identified among main difficulties. Additional costs resulting from the indicated barriers increase the cost of exporting to Japan by 10–30%, depending on the sector, and 2/3 of surveyed companies reduce the variety of exported goods due to existing barriers in access to Japanese market[12]. Among the main obstacles for European business when entering and operating the Japanese market are as in Table 5. Here, specifically food and agricultural products, pharmaceuticals and cosmetics, and automobiles and automotive components will be mainly discussed.

12 60% of EU exporters stated that they have a smaller or much smaller product range in Japan than other markets in Asia; 39% declared that their firm offers substantially fewer products on the Japanese market than other Asian markets (Sunesen et al., 2009).

Table 5 International trade barriers

Categories	Elements	Typical Export Categories
Tariff related	Punitive tariffs	Automobile, foods
Restriction related	Food standard	Foods, agriculture, beverage
	Restrictive issuing of permission	Pharmaceuticals, cosmetics
	Strict licensing system	Alcohol wholesale, pharmaceuticals
Custom related	Unfair competition rules	Wholesales,
	Complex procedure for opening outlets	Leather retail

(Source: FTA, 2013)

3–1. Food and agricultural products

In the context of the above mentioned obstacles difficult negotiations may be expected in liberalization of trade in agricultural products which is among priorities of EU negotiators. Japan remains one of the most important export markets for the EU producers. The country with a share in total EU agricultural and processed agricultural products export at 4.1%, ranks as the 5th export destination for the EU (EUR 5,354.0 million in 2015).

However, the Japanese food and agricultural products market has been strongly protected by both highly tariff and non-tariff barriers. In terms of high rate tariff, in 2015, the simple average final bound tariff was at the level of 18.2%[13] and only 1/3 of agricultural products import (by % of tariff lines) was duty-free. Tariff rates for food and agricultural products reach peak levels in this group of goods. The most protected products group is dairy products with an average applied tariff at 76.3% and only 9.1% of duty-free lines[14].

The Japanese market of imported food and agricultural products remains inaccessible not only due to high tariffs, but also many existing non-tariff barriers, which are recalled by EU exporters as relevant impediment for trade expansion. Among the main protectionists barriers to import of agriculture products and food are listed for mostly license regimes as well as import surcharges and import permits. Those restrictions, applied to liquors, dairy frozen products, and soft drinks make import very difficult. As for rice imports are limited by quotas (FTA, 2013).

Regarding the import of alcoholic beverages special restrictions refer to both import and sale of those products at the Japanese market. For example, malt and quota management system, based on tariff quota system for brewing-malt, allows that a company must manufacture beer or import malt exclusively for the use of a particular brewery. Additionally, application for the quota are only twice a year, which means that any imports using the quota must be based on forecasts and not on actual short-term demand. The system,

13 Simple average of the most favored nation treatment (MFN) applied at 14.3%.
14 Tariff peak rate in this group reaches 586.0%.

aimed at protecting Japanese barley farmers and malt manufactures, brings impediments for imported products of this category (EBC, 2015).

Japan applies also a strict liquor wholesale licensing system, in which quotas are reallocated only once per year (FTA, 2013). The licensing system is complex and applications are not processed in a clear, transparent and consistent manner. Moreover, prices of liquor are controlled by the National Tax Agency and the categorization of alcoholic beverages for tax purposes is different from that one used in the EU countries or the United States. It is often declared by European exporters that product definitions for alcoholic beverages in Japan are broad and do not comply with internationally accepted product specifications that are based on production methods and geographical indications. Moreover, the geographical indication terminology in Japan is not compatible with the EU-origin concept and rules and threatens to undermine European products in the Japanese market (EBC, 2008; EBC, 2015). Although the Japanese liquor market belongs to one of the largest in the world, it still remains mostly controlled by domestic producers with a very limited access for imported products, including those from the EU. In 2014, imported products constituted only 4% of the total Japanese liquor market (EBC, 2015).

Other relevant obstacles indicated by European exporters derive from the fact that Japanese domestic regulations in many aspects are not harmonized with internationally recognized standards for food safety and quality. This also applies to animal and plant trade. High costs of additional conformity tests because of denial of acceptance by Japanese authorities of evaluations made by the EU/international bodies, constitute an additional burdensome barrier for export to Japan. Many food additives of worldwide common use and recognized as being safe by international food safety bodies such as the Joint FAO/WHO Expert Committee on Food Additives (JECFA) remain prohibited by Japan (EC, 2008). This eliminates completely from the sale and import many products containing the additives and therefore creates serious trade barrier for EU export of food products. Substantial increasing of the list of recognized by the Japanese authorities food additives together with shorten and revised approval process as well as progress in mutual recognition of conformity assessment procedures would eliminate the duplicate costs of evaluations and enhance the access for European exporters to the Japanese market of food products (EU-Japan BRT, 2013).

The problem of denial of international standards refers also to other aspects of trade in food and agricultural products, including animals and plants[15]. There is no regulatory compliance with CODEX standards for safe food additives and testing regimes for pre－ and post－harvest pesticides. Moreover, exporters to the Japanese market accentuate

15 Different regulations on organic food, standards on non-quarantine pests are not in line with international standards, legislation on trade in beef and other BSE products is not in line with the World Organization for Animal Health, plant quarantine regulations are not in line with GATTs Sanitary and Phytosanitary chapter.

many other technical and administrative barriers for trade in food and agricultural products, which next to high tariffs and incompatibility impede effectively import to Japan, such as slow process of examination of the data submitted and the questions to what is necessary for risk assessment for meat/beef import, different standards for labelling, high fumigation costs, or low tolerance regime for insects or the requirement for an individual organic certificate to accompany every shipment (EBC, 2008; EBC, 2014; EBC, 2015; Sunesen et al., 2009).

3-2. Pharmaceuticals and cosmetics

The Japanese market, due to its size, ageing population and level of spending on healthcare is perceived also as an attractive market for European producers of pharmaceuticals[16]. Although during recent years in many barriers such as incompatibly of Japanese regulations with international standards, insufficient reward of products' innovation or burdensome import processes (Sunesen et al., 2009) some progress has been achieved, making import and the pharmaceuticals market in Japan more transparent and accessible, there are still non-tariff barriers with a destructive effect for import.

In 2010 the Japanese authorities introduced on a trial basis[17] an innovation premium known as the "premium to promote the development of new drugs and eliminate off-label use". The initiative has resulted in a sharp increase in the number of new drug development projects in Japan, which was the main target of the initiative. However, there are still regulations, which are perceived as burdensome for introducing innovative products into the market. For example, a regulation on max. 14 days prescription of a drug during the first 12 months after it is launched, results in situation in which new drugs are not commonly prescribed. It is described by many producers as an unnecessary rule and as such acts as a barrier for innovative new products (EBC, 2014).

Even more complex problem for European exporters of pharmaceuticals are limitations in clinical trials. Although the Japanese Good Clinical Practice (GCP) in clinical trials has been conformed to international standards in recent years, there is still a need to reduce differences between Japanese medical institutions in the efficiency of the clinical trials they conduct. European producers and exporters also complain about the insufficient scope of the Mutual Recognition Agreement (MRA) for EU[18] and Japanese Good Manufacturing Practice (GMP), which results in duplication of inspections and tests leading to increase in delays and costs (EBC, 2015). Also, national tests for vaccines should be eliminated or reduced to an absolute minimum (EU-Japan BRT, 2015).

Some controversies still also arise around the IPR related to pharmaceuticals. As in many other FTAs negotiated by the EU, European producers and exporters aim not only

16 In 2014/2015, 10.3% of GDP compared to the OECD average of 9.3%
17 Extended in 2012 and 2014.
18 MRA entered force in 2002.

at better access to foreign domestic markets, but also on improving patent protection of their products. In this connection, the European business is in a position that the Japan Patent Office (JPO) should consider supplementary experimental evidence to support generic drug patent claims, as the current practice is that for many types of applications the JPO grants only protection for embodiments disclosed in the application as filed (EU-Japan BRT, 2013).

Other group of products which is important to European exporters and which still faces burdensome barriers in import to the Japanese market constitutes cosmetics and quasi-drug products. Although the EU is an important supplier of those products, due to their value recognized by Japanese consumers, there are still non-tariff obstacles to trade.

Similar to food and agricultural products, trade in cosmetics and quasi-drug products is negatively affected by the low harmonization of products standards, regulations on ingredients, permitted efficacy claims as well as standards for alternatives to animal testing (Sunesen et al., 2009). Additionally, a slow validation process of testing on cosmetics makes that the launch of European products in Japan is often severely delayed, even though the same products are in global use and have clinically proven efficacy. European exporters also claim that there is a lack of sufficient access to information on the approval of different ingredients in Japan. The process is even more complicated as the approval of products meeting existing approval standards is delegated to the prefectural authorities, which sometime leads to differences in interpretation by different prefectural offices (EBC, 2015).

3–3. Automobiles and automotive components

One of the most important issues to be addressed in the agenda of ongoing negotiations for the EU-Japan FTA is trade in automobiles and automotive components. Both parties are world-scale car producers with worldly recognized brands. The European Union is the 2nd biggest producer of motor vehicles in the world and Japan ranks at the 4th position[19] (OICA, 2016). Regarding trade in automobiles between the EU and Japan, there is a noticeable imbalance in trade. The EU market is more attractive for Japanese car manufacturers than the other way round. According to an analysis prepared by Deloitte Consulting the Japanese market is not a strategic market for EU car producers and its shrinking tendency and traditional 'inward looking' character do not bring promising future prospects for EU exporters (Deloitte, 2012).

The European automobile manufacturers are skeptical about the benefits of EU-Japan free trade agreement which is being negotiated. The skepticism derives from forecasted effects of FTA on trade in cars as well as existing import barriers in the Japanese market and its organization. According to the analysis it is estimated that FTA would result (by

19 As a national economy, Japan ranks at the 3rd after the United States and China.

2020) in 443,000 additional units exported from Japan to the EU and only in 7,800 additional units exported from the EU to Japan. In contrast to the EU market, which is predicted to grow in size in forthcoming years, the Japanese market is forecasted to shrink due to demographic trends. Moreover, it is strongly inaccessible due to non-tariff barriers posing significant obstacles for more effective market penetration. Additionally, the Japanese market is quite specific－preferential treatment[20] is given to the mini car segment (Kei), which currently constitute more than 40% of all sold cars (in 2014－2,272,789 units and a record market share of 40.9%). Moreover, the segment is predicted to grow to 1/2 of the total market by 2020. The production and sale in this segment is dominated by the Japanese producers, which naturally eliminates European manufacturers and exporters form the significant share of the market (Deloitte, 2012).

As the FTA does not address the issue of trends and structure of the Japanese car market and consumers' behavior, the agreement is expected to improve access especially in reference to current regulatory non-tariff barriers. The low level of harmonization of Japanese standards with internationally recognized ones, which has been already evoked several times in other product groups, applies also to trade in automobiles and automotive components. In this context, European exporters perceive the harmonization of technical standards and certification procedures as the most important step to improve their export possibilities that should be addressed in EU-Japan negotiations agenda. The EU representatives accentuate that Japan, although being a signatory of the UN-ECE (United Nations Economic Committee for Europe) 1958 Agreement on the harmonization of technical requirements and certification procedures, still does not approve some standards covered by the UN regulations[21] and does not accept a UN certificate as demonstrating compliance with Japan's national requirements (EBC, 2015). Steps towards harmonization and full adoption of UN standards would allow to sell in Japan vehicles certificated in the EU without modifications or further testing.

Similar efforts of adopting international standards should be also undertaken in reference to requirements for commercial vehicles (EC-Japan BRT, 2015), where national Japan's regulations on the maximum width, length and axle load for buses, the method of calculating gross vehicle weight and the endurance testing requirements for emission control devices for heavy-duty vehicles create additional restrictions for European exporters. However, it should be underlined as some progress in this issue has been made last time and 2016 witnesses further progress in harmonization (adoption of International Whole Vehicle Type Approval (IWVTA) system) (EBC, 2015).

Low harmonization with UNECE standards as well as lack of recognition of foreign tests hampers also trade in automotive components. Those barriers together with still

20 In terms of tax, insurance, motorway tolls and parking registration.
21 For example, emission of pollutants, CO 2 emissions and fuel consumption and noise are adopted.

existing reliance of Japanese producers to co-operate with affiliated companies as well as legal system distorting free and open competition in the procurement of component make the Japanese market difficult place for trade in automotive components. In this context Japan, as one of the greatest car manufacturers in the world, presents itself for European exporters as a very attractive market due to its size and production structure, however with many still existing technical and administrative barriers (EBC, 2015).

European producers perceive also as a significant barrier in access to the Japanese market regulatory and fiscal privileges applied to Kei cars segment (Sunesen et al., 2009). This system of classification as well as privileges given to those specific vehicles make that European producers are out of the lion's share of the passenger car market in Japan[22]. In this context, European exporters demand from Japan authorities to put Kei cars to the same regulatory and fiscal footing as for other motor vehicles (EBC, 2014), which should enable to penetrate more effectively this segment for foreign exporters and also stimulate development of other market's sectors which are currently under discriminatory provisions. Moreover, the European exporters also recommend reforming the automobile tax system in Japan based on international best practices[23]. Additionally, the EU also encourages to adopt together by the EU and Japan internationally harmonized standards to measure fuel efficiency and exhaust emissions, which would be a base for tax system promoting environmentally friendly vehicles (EBC, 2015).

4. An Analytical Framework

Generally, FTA is expected to solve above listed problems, especially tariff and regulation issues. According to standard international economic theory, free trade can be expected to improve a country's economy (Bhagwati et al., 1998). This belief is based on comparative advantage theory. The theory suggests that any country can export a specific product if the theory could work. Even lower productivity country compared to another country can export when relative productivity difference between products exist in a country. Gandolfo (1998) explains that comparative advantage can be defined as the ratio between the absolute unit costs of the two commodities in the same country, or as the ratio between the absolute unit costs of the same commodity in the two countries.

Even in pure and rigorous theoretical setting, comparative advantage can work under very strict conditions. First, these two countries differ from each other. One important contribution of comparative advantage theory is that even small country can export some product to large country. Here, small country means less productivity. Second, each country must transfer its economic organizational structure quickly, and without any political

22 It applies even to European compact cars.
23 Tax system on the purchase and ownership of motor vehicles.

interruption.

Table 6 shows a situation in which comparative advantages are working. Here, assume two countries, Thailand and Japan, produce the same products (car and rice). Now, Thailand can produce 900-ton rice by 100 labor and 300 cars by 100 labor. In contrast to Thailand, Japan can do 1000-ton rice and 500 cars by same labor resources. In this case, Japan has absolute advantage for producing both products than Thailand does.

Table 6 Example of comparative advantage theory

	Rice		Car	
	Production	Labor	Production	Labor
Thailand	900	100	300	100
Japan	1000	100	500	100
Total	1900	200	800	200

However, Thailand can export rice because it has comparative advantage of producing rice compared to Japan. Now, consider an opportunity costs.

Thailand: 1 rice = 300/900 (1/3) car
Japan: 1 rice = 500/1000 (1/2) car

Under this condition, Thailand has comparative advantage to produce rice with lower opportunity cost than Japan's. It is better for Thailand to concentrate on cultivating rice. Now, both countries have shifted their production organizations in Table 7. From this new economic organizations, both countries gain additional benefits below.

Table 7 Improved productions by comparative advantage

	Rice		Car	
	Production	Labor	Production	Labor
Thailand	1800	200	0	0
Japan	300	20	900	180
Total	2100	220	900	180

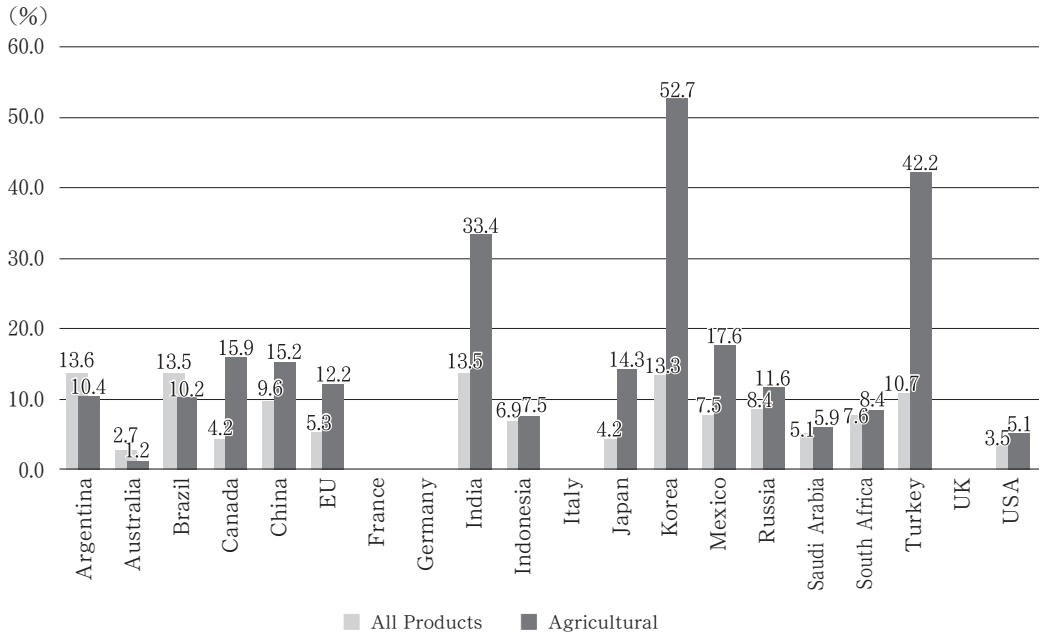
This standard understanding praises international free trade. Theoretically, comparative advantage is rigorous and robust and economically is expected to improve economic performance as above example. However, FTA sometimes encountered difficulties and often delayed to reach the agreements. Here, these three agenda should be considered.

First, comparative advantage assumed some significant difference between two countries, though between EU and Japan, there are few differences. The difference is smaller than similarity is. The EU specializes in producing pharmaceuticals, automobile, organic

chemicals, optical devices, and prime mover (compact motor), and so on. So does Japan. Even this situation, international trade can execute between two countries. Only cost differences matter, theoretically. This means, if cost difference would not exist, trade did not proceed. Both countries will not gain any benefit from the trade. Second, this is related to the first one, but a few more practical. If there is big comparative advantage to rice in Thailand, the country which does not eat rice will not import rice. Theoretically, exchange rate will increase extremely high. Any export product will encounter the selling problem which is the same in domestic marketing problem. Customers do not buy what they do not want, neither need. Practically, export process does not begin with exchange rate fixed, but possibility of export is the first. And third, free trade agreement is sometimes interrupted politically. Economic motivation can go over national boarder easily, but politicians protect and keep the peace of a nation. Specifically, agriculture in Japan has been protected by several ways because it can organizationally vote in a specific political party. To them, any evidence and any scientific explanation will not work.

For instance, tariffs of Japan are generally low among G20 countries. Japan is already relatively open country. Figure 7 indicates samples of tariff in G20 countries. The figure shows two legends: the average of all products by gray column and average of agricultural products by green column. The highest tariff of all products average in G20 countries is in Argentina (13.6%) and the lowest in Australia (2.7%). The rate in Japan is 4.2%, lower than the average for the EU (5.3%).

In agricultural products, the highest tariff is applied in Korea (52.7%) and the lowest



(Source: WTO, 2015b)

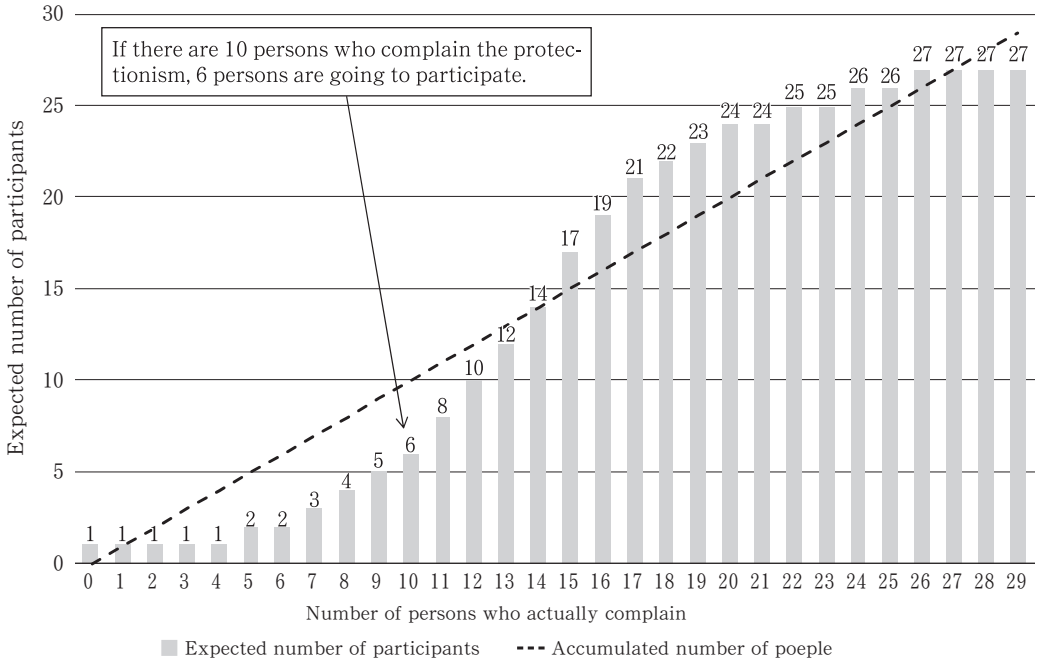
Figure 7 Average tariffs for agricultural products MFN applied 2014 in G20 countries

in Australia (again, 1.2%). Sometimes Japan is described as a high-tariff country for agricultural products, but this figure revealed the fact. It is 14.3% and not so high among G20 countries. Tariff for rice in Japan applies JPY 402 (EUR 2.8, 2016) per kg. This sometimes is called over 600% or 700% tariff.

This evidence shows Japan is not a high tariff country, rather lower than the average country. The specific item, rice, becomes one extreme case, and consequently a naive impression of Japan as a highly protected market. This is the domestic political issue, nothing else. Someone certainly gains benefit under this impression. In Japan, it is publicly known that the association community of agriculture has been dominated Japanese agriculture after World War II.

The standard international economic theory explains that the import of cheaper goods improves real incomes in importing country (Krugman et al., 2014). Political issue sometimes will be skewed by a few manufactures. Many consumers will gain benefits from free international trade, loss concentrates on a few manufactures. They strongly reject FTA. For example, the United States restricts sugar import. It can be evaluated that consumers in the United States waste for six dollars in a year (in total USD 150 million). Though consumer will not have positive incentive to introduce FTA, they will have strong incentives to protect FTA because sugar producers gains from this restriction.

Though it is sometimes rationally criticized, protectionism can survive because it proclaims nationalism. Japanese case must match to this case. Though rice had imported



(Source: Yamagishi, 2002, p. 68)

Figure 8 An analytical framework of political behaviors

from China, it was often regarded as Japanese origin and could be expressed Japanese soul. Practically, there is no rational solutions to this protectionism, but only time passing, generation change. Consider analytical framework by using Figure 8.

This figure has two dimensions. The horizontal axis refers to number of persons who complain against protectionism. This dimension begins 0 to 29.0 means that there is no person who is complaining protectionism now. The horizontal axis indicates the number of persons who are going to participate if the number of column bar displays. For example, there is one person who is going to participate the claim, if there is no actually complaining person, namely, the horizontal number 0 and the vertical 1. At the horizontal number 10, this means there will be expected 6 persons who are going to participate the claiming, if there are 10 persons who are actually claiming now. This figure describes dependent behavior among Japanese. It is said that Japanese often are influenced by the others' opinions. This is a kind of collectivism and actually regarded as the frequency dependence decision-making, it means the more, the better. It can be said complement equilibrium.

Now, assume a village with 32 residents. The village has one politician and 31 industrialists. Each of residents has own different business. International trade policy of this village is moderate protectionism. Most of industries have been protected by tariff. However, recently some industries are getting opened internationally, but abacus producer is strongly protected with extremely high tariff. Hence, this village lays on 600% tariff on an electronics calculator. 30 people in the village felt discontent with this protectionism, but the politician agitated that the abacus was the village tradition, it represented village's soul. 30 people could not protest severely because they also would like to protect their own industries.

From the figure, it is apparent if there are 14 persons, this complaining activity can achieve the purpose. Because, there are 17 persons who are waiting for participation, if there are 15 persons were complaining. In contrast to accumulation, if 13 persons are complaining against protectionism, only 12 persons would like to join. In this case, the number is quickly going to decline to 1.

For the above discussion, one implication can be derived that the initial condition is critical. For instance, as the initial condition, 13 persons would agree to open the market, but this case Japan cannot achieve the political consensus because a few persons will quickly withdraw from participation. Therefore, the pragmatic issue to introduce new practices will focus on what influences the initial condition. As suggested above, it might be generations. For instance, in above case, a certain generation has learnt how to use abacus and many people are good at abacus calculation. They cannot abandon abacus for calculation, then, their preference will be tended to protect the abacus industry. However, next generation is not good at calculating with abacus, rather the electronic calculator. This generation does not hesitate to eliminate the tariff.

Conclusions

The purpose of this paper is to develop the preliminary analytical framework for fostering FTA negotiation between EU and Japan. The existing barriers for European exporters are mostly of non-tariff character[24]. This creates situation in which the issue of non-tariff barriers should be addressed as the biggest challenge for European negotiators in improving access to the Japanese market for European exporters. The non-tariff barriers are especially burdensome in sectors of a great importance to the EU exports[25] and in sectors, where currently applied tariffs remain relatively low.

Although there are still some tariff peaks in different product groups[26], the non-tariff barriers remain one of the main stumbling blocks slowing down the progress of the whole EU-Japan FTA negotiations (Nelson, 2012). The low harmonization of standards with those recognized commonly in the world (also by international organizations such as UNECA) and the lack of transparency of existing national regulations and processes (e.g., licensing) are listed among the most burdensome barriers to trade and investments.

Not only manufacturers, but also many European service companies[27] face discriminatory treatment at the Japanese market through domestic national regulations for specific sectors, restrictions introduced by local authorities as well as nontransparent (and sometimes unique compared to global environment) regulations relating to foreign direct investments and competition policy. European exporters/investors face also many barriers in access to Japanese public procurement sector. Main problematic issues in this area include the lack of single public procurement offers database, unclear qualification conditions, restricted tenders list, high value thresholds for contracts open to foreign providers and required experience in providing goods and services in Japan.

The economic potential of the EU and Japan make the future free trade agreement one of the most important trade frameworks between developed countries. The successful conclusion of the ambitious and comprehensive EU-Japan FTA, and through this tackling the differences between economic and business systems of the European Union and Japan, is of crucial importance to both partners not only to stimulate bilateral economic and trade links, but also to give a new impetus for economic growth on both sides. As stated in many analysis and comments, Japanese FTAs, including that being negotiated with the EU, might be used by politicians as an argument for reforms and restructuring of some Japanese economy sectors (as a next step of *Abenomics*), which should be implemented whether the comprehensive agreement will be finally achieved or not.

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24 There is relatively low tariff for goods imported to Japan from the EU.
25 Processed food and agricultural products, pharmaceuticals and transport equipment.
26 Processed food and agricultural products, leather, footwear.
27 Mostly in finance, banking, telecommunication, postal services and transport.

Stronger presence of European business in Japan, also through foreign direct investments, should increase competition at this relatively restricted market and stimulate increase in competitiveness of many sectors of Japan's economy. The forecasted impact of the comprehensive EU-Japan free trade agreement indicates that the GDP of partners－the EU and Japan－would increase by 0.8% and 0.7% respectively. Moreover, the EU export could increase by 32.7%, while Japan's export to the EU would expand by 23.5% (EC, 2012). As the economic relations during the last decade have been considered to be below economic potential of both partners, the new agreement should support revitalization and actuation of bilateral trade and investment links.

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